

# Oh Snap! UK Election Surprises

June 2017

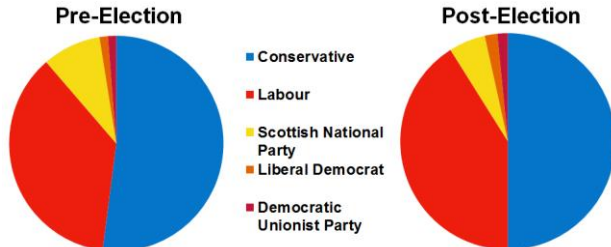
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- Conservatives lost 13 seats in the UK election on 8 June, eliminating the party's parliamentary majority.
- The election dealt a significant blow to a small-but-influential number of conservative hard-line Brexit proponents, increasing the probability of a softer, more business-friendly Brexit, which is a positive development for UK service industries and the City of London.
- SEI sees no reason to change our investment strategies in the wake of the vote.

Conservatives lost 13 seats in the election, eliminating the party's parliamentary majority, which was the reverse of their intention when Prime Minister Theresa May called a snap election in early April. Conservatives appear likely to form a coalition government with the Democratic Unionist Party (DUP) of Northern Ireland.

Labour gained 30 seats, so it will wield more power in opposing enactment of the Conservative agenda. The Scottish National Party suffered the greatest losses (21 seats), laying to rest the issue of another referendum on Scottish independence for now.

## Exhibit 1: UK Election Outcome



Source: BBC News. As at 12 June 2017.

## A Softened Hard Line

Prime Minister May now leads from a substantially weaker position, and while she has expressed no intention to resign, it may only be a matter of time before her party chooses a replacement. It's entirely possible that timeframe could include the full scope of Brexit negotiations.

Ahead of the election, Prime Minister May had promoted a willingness to pursue a hard-line break from the EU if a good deal could not be negotiated. That hard Brexit outcome is now in question.

Indeed, voters appeared to project a preference for a softer Brexit. The election dealt a significant blow to a small-but-influential number of conservative hard-line Brexit proponents. The relative shift in

fortunes between anti-austerity Labour (which has espoused a preference for soft Brexit and an increase in social welfare programs) and austerity-minded Conservatives reinforces this point.

## Market Reaction

Markets took the result in stride as at 9 June 2017. Granted, polling partially prepared investors for this outcome as it showed Conservatives move from a substantial lead (and the likelihood of an expanded majority) to a tighter race (and a greater-but-still-small probability of the realized outcome).

Sterling fell against most currencies but seems to have stabilised. Gilts were largely unaffected. UK stocks were down only slightly, while most European bourses were positive.

## SEI's View

These election results may have delayed the increase in certainty that would have accompanied an enhanced Conservative majority. But the market reaction suggests that the outcome was not unpalatable to investors.

The UK has essentially traded one type of uncertainty for another: the risk of economic and political rupture with the EU has gone down, while the risk of domestic political dysfunction and paralysis has increased.

Importantly, the continued uncertainty contains an upside. The probability of a softer, more business-friendly Brexit has increased, which is an improvement. The maintenance of economic and political ties between the UK and EU would be a positive development for UK service industries and the City of London.

Soft Brexit is still not a certainty. The EU will help dictate the final outcome and it's possible, if not likely, that Prime Minister May could entice the DUP to tolerate a Hard Brexit with political bequests.

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